



CONSUMER
& INDUSTRY
SERVICES

VIATICAL SETTLEMENTS:

The Undisclosed Risks;
What Every Investor Must Know

WARNING:

Do not invest in viatical settlements until you
have read the following information.

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What is a Viatical Settlement?

Following is a brief, general, overview of how viatical settlement investments work.

A viatical settlement is an arrangement between the owner of an insurance policy (the *viator*) and a third party (the *provider*). The provider negotiates with the viator for the purchase of his/her life insurance policy or the beneficiary rights under that policy. The broker then solicits funds from investors. The funds are used to consummate the viator-provider purchase/sale agreement.

Viators are typically terminally ill persons expected to die within 24 to 36 months. The viator receives a percentage of the face value of his/her life insurance policy. The viator may use the money for whatever he/she desires, typically it is used to pay current medical expenses and fulfill last wishes.

Upon the viator's death the investor or group of investors collects the value of the policy less any deducted expenses involved in the investment. This money is then distributed to the individual investors based on each's percentage of investment.

The State's Role

To date Michigan has enacted legislation protecting the viator. Under the law the Michigan Insurance Commissioner is vested with the authority to oversee the viator-dealer end of the viatical settlement process. The investor-provider end of the viatical settlement investment falls under the purview of the Michigan Uniform Securities Act.

Viatical settlement contracts are considered securities on the premise that the sale of fractional interests in a viatical settlement to investors is a securities transaction.

As a New Investment Vehicle

Viatical settlements are fairly new. They were first publicly discussed as an investment vehicle in the mid 1980's and have only been widely available to the general public for the last three years.

While every investment carries with it the risk of loss due to fraud or otherwise, many investors who lose money to viatical settlement investments lose it because they were not given the full or correct information concerning its risks. Sometimes it is simply that the information was available but the investor did not ask. Regardless of the specific circumstances, there are several risks inherent in a viatical investment of which all investors should be aware. A well informed investor is a prepared investor.

Important Risks

Factors that should be considered before investing:

- Rates of return may be projected but cannot be guaranteed since advances in science and medicine may increase a viator's life beyond that which can be foreseen. So while a viatical company or salesperson might "guarantee" a particular rate of return on your investment, remember that the rate of return on an investment in viatical settlements cannot actually be calculated since the longer a viator lives, the lower the rate of return on your investment will be.
- No one can accurately predict the life expectancy of a viator. This is true not only because of possible breakthroughs in treatments and cures for AIDS and cancer but also because of many other variables such as: the experience of the medical personnel making the prediction; the nature of the viator's illness; and, if the viator has AIDS, the definition of AIDS used by the viatical company.

- Who will be responsible for paying the premiums. If the policy premiums are not paid the insurance company will cancel the policy. Many viatical companies collect enough money from investors to cover the costs of paying premiums for the life expectancy of the viator; however, it is important to address the issue of who pays the premiums when the viator outlives his/her life expectancy.
- Term insurance policies have unique risks. A term policy is a policy issued for a definite period of time. If the viator outlives that time period the insurance company will not pay the death benefit. If your investment is in a term policy you should be aware of who will be responsible for renewing the policy when the term expires.
- Group policies are also unique. A group insurance policy is one that covers a specific group of individuals such as the employees of an employer. These policies may be converted to an individual policy; however, many group policies contain restrictions for such a conversion. If the viator's policy was converted from a group policy, any restrictions may pose problems for investors. A typical example is that the group policy premiums may be lower than those of the converted individual policy.
- Most policies have a contestability clause. A contestability clause allows the insurance company to "contest" the policy if a claim for benefits is made within two years of the policy's effectiveness. Contesting the policy means that the insurance company believes there is legal justification to deny the claim for benefit payments. Legal justification may be that the viator's death was an act of suicide or murder by an interested party, or even that the viator was not completely honest when applying for the life insurance.

The insurance company will not pay the benefits if the viator dies within the contestability period AND the insurance company believes it has such justification to cancel the policy.

- The policy may also be contested by family members. Keep in mind that some family members, when aware of the policy and its benefits, may challenge the validity of the viatical settlement in court. This could delay payment, thus reducing your rate of return.
- Viatical settlements may carry significant risks for older investors who may be looking forward to the funds for living or medical expenses of their own, since investors may be asked to pay additional premiums or wait for a return on their investment for a period of time beyond that originally expected.
- IRA tax benefits may not be available if IRA funds are invested in viatical settlements. Internal Revenue Code section 408(a)(3) requires that, "no part of trust [IRA] funds will be invested in life insurance contracts."
- The timing involved with IRA's may also cause problems. Because the IRS requires individuals to draw money from their IRA at 70 1/2 years old, investors need to consider both their age and the viator's age and possible life span when investing. There will be substantial penalties by the IRS when you reach age 70 1/2 if IRA money cannot be distributed because the viator is still alive.
- Viatical settlement investments are not liquid investments. A liquid investment is one that can be easily disposed of by either selling the investment interest to another investor in a secondary market or by cashing it in for value with the issuer. Be advised that there may not be a secondary market for viatical settlement investments, and further, there can be no guarantee of a payout of funds via the death benefit.

- Check promises and “guarantees” closely. The viatical company may provide a fidelity bond or a performance “guarantee” or other similar instrument with your purchase. This idea is to ensure that investors will still get paid if there is a problem with the payout of beneficiary proceeds from the insurance company. If such a “guarantee” is provided, ask for a copy of the instrument as well as a copy of the contract between the viatical company and the company issuing the instrument. Also, contact the appropriate state regulatory agency to determine if the company issuing the “guarantee” is legitimate; try to obtain the company's financial statements. These are important steps because:

- The contract between the viatical company and the issuer of the instrument may affect the guarantee to you; something the contract may expose.

- The company issuing the guarantee may not have the financial resources to make payments under the guarantee; something financial statements should indicate.

- The life insurance company may go out of business. While Michigan has an insurance guarantee fund that provides money for beneficiaries of insurance companies that go out of business, that fund is limited to \$100,000 per life insurance policy. Also, the process of collecting from this source may be delayed for viatical investors. A delay will reduce the rate of return on your investment.

- There is an increased opportunity for fraud where the viator is unidentifiable. Always contact the insurance company to determine whether or not the viator actually exists. Many insurance companies may limit the information available, but some will disclose whether or not they have issued a life insurance policy to that person.

- The policy may be sold to more than one party. There is always the risk that the viator has sold his policy to two different viatical settlement companies. While most legitimate viatical settlement companies will perform due diligence investigations to combat this, it is a possibility. Ask whatever questions you feel are necessary until you are comfortable with the answers.

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Who To Contact:

Questions regarding the viatical settlement industry should be directed to:

Michigan Department of Consumer & Industry Services
Office of Financial and Insurance Services
P.O. Box 30220
Lansing, MI 48909-7720

Toll-Free Phone: (877) 999-6442

<http://cis.state.mi.us/ofis/>

Complaints regarding the purchase of a viatical settlement should also be directed to the Office of Financial and Insurance Services:
(877) 999-6442

Other helpful publications may be obtained from the:

National Association of Insurance Commissioners
120 W. 12th Street, Suite 1100
Kansas City, MO 64105

Phone: (816) 842-3600

<http://www.naic.org>